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In the Supreme Court of the United States

OCTOBER TERM, 1969

No.

UNITED STATES OF AMERICA, PETITIONER

v.

HILTON HOTELS CORPORATION

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT

The Solicitor General, on behalf of the United States of America, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Seventh Circuit in this case.

OPINIONS BELOW

The opinion of the district court (R. 36-40)[1] is reported at 285 F. Supp. 617. The opinion of the court of appeals (Appendix A, *infra*, pp. 18-23) is reported at 410 F. 2d 194.

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[1] "R." refers to the printed record in the court of appeals entitled "Appendix".

JURISDICTION

The judgment of the court of appeals was entered on April 15, 1969 (Appendix B, *infra*, p. 24). By order dated June 30, 1969, Mr. Justice Stewart extended the time for filing a petition for a writ of certiorari to and including August 28, 1969. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

QUESTION PRESENTED

Whether for federal income tax purposes, expenditures incurred by a corporate survivor of a merger in connection with an appraisal proceeding to fix the value of dissenting shareholders' stock in the merged corporation are deductible as an ordinary and necessary business expense, or are nondeductible capital outlays.

STATUTES AND REGULATIONS INVOLVED

The pertinent provisions of Sections 162 and 263 of the Internal Revenue Code of 1954 and Section 1.263(a)-2 of the Regulations thereunder are set forth in Appendix C, *infra*, pp. 25-26.

STATEMENT

As of September 1953, Hilton Hotels Corporation ("Hilton") owned 325,370.5 of the 366,040.75 issued shares of Hotel Waldorf-Astoria ("Waldorf"). In August 1953, Hilton retained Standard Research Consultants, Inc., to prepare a merger study to determine the number of Hilton shares that would be a fair basis for an exchange for each of the 40,670.25 outstanding Waldorf shares not held by Hilton. The

final report submitted by Standard Research in October 1953 concluded that Hilton would be justified in offering 1.25 shares of its common stock for each share of Waldorf stock as a fair basis of merger. (R. 5-6.)

On November 12, 1953, Hilton and Waldorf entered into an agreement of merger which provided that Hilton would be the surviving corporation and 1.25 shares of Hilton stock would be offered for each outstanding Waldorf share not held by Hilton.[2] Subsequently, on December 28 and 29, 1953, the holders of more than two-thirds of the stock of Hilton and Waldorf voted to approve the merger. Prior to the vote, the holders of 20,221 Waldorf shares, pursuant to Section 91 of the New York Stock Corporation Law, filed with Waldorf their written objections to the merger and demanded payment for their stock. Thereafter, on December 31, 1953, the merger agreement and the certificate of consolidation were filed and recorded with the Secretary of State of New York, pursuant to Section 91 of the New York Stock Corporation Law. (R. 6-7.)

On January 7, 1954, Hilton offered to the dissenting holders of the 20,221 Waldorf shares a payment of $24.54 per share. The offer was rejected and the dissenting shareholders began proceedings, pursuant to Section 21, New York Stock Corporation Law, in the Supreme Court of New York (New York County)

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[2] The Waldorf shares held by both Waldorf (as treasury stock) and Hilton were to be cancelled upon the filing and recording of the merger agreement (R. 6).

for a determination of the value of their Waldorf shares. (R. 7-8.)

During the period January through May, 1954, Hilton asked Standard Research to value the Waldorf common stock as of December 27, 1953, the day prior to the shareholders' vote approving the merger. This valuation study included the preparation of charts and tables supporting its opinion and the giving of testimony in the appraisal proceedings. The amount paid to Standard Research for all of its services (both before and after December 31, 1953) was $17,500. Hilton also obtained the services of lawyers and other professional services in connection with the appraisal proceedings. The fees for these services came to $39,758.62. Ultimately, the appraisal proceedings were terminated by order of the New York County Supreme Court on June 14, 1955, upon its approval of the parties' settlement.[3] (R. 8, 9-11.)

The sole issue litigated in the district court was whether the fee paid to Standard Research and the other fees and costs incident to the appraisal proceeding were nondeductible capital outlays, as the Government contended, or were immediately deductible ordinary and necessary business expenses, as Hilton urged. Hilton conceded and the district court held that so much of the payment to Standard Research as pertained to the determination of a fair basis of

[3] The settlement provided for payment of five-eighths of a share of Hilton stock for each share of Waldorf stock, but without any fractional shares issued. In addition, Hilton was to pay $6 for each one-eighth share of Hilton common stock which would have otherwise been required to be issued as a fractional share. (R. 9-10.)

merger between Waldorf and Hilton could not be currently deducted. This holding was based on the established rule that expenses incurred in connection with a corporate reorganization are nondeductible capital outlays. (R. 36-37.) The district court concluded in favor of respondent, however, that the fees and costs relating to the appraisal proceeding were currently deductible on the ground that the "merger was already effective and the expenses incurred by the corporation in the appraisal proceeding were not reorganization expenses" (R. 39). On appeal, the Seventh Circuit affirmed (Appendix A, *infra*, pp. 18-23).

REASONS FOR GRANTING THE WRIT

The decision below is directly in conflict with that of the Eighth Circuit in *Woodward* v. *Commissioner*, 410 F. 2d 313, affirming 49 T.C. 377, taxpayer's petition for certiorari pending, No. 412, this Term,[4] and is at odds with well-settled case law concerning the tax treatement of expenditures incurred in connection with acquisitions of capital assets and corporate reorganizations. Because of the large number of corporate acquisitions in recent years, the question whether the costs of appraisal proceedings are capital expenditures or currently deductible expenses is a recurring one in the administration of the Internal Revenue Code. This Court should resolve the conflict to eliminate confusion in this area of the tax

[4] The Commissioner intends to acquiesce in the grant of the petition in *Woodward*.

law and to ensure even-handed treatment of similarly situated taxpayers.

1. The federal income tax law has long made the distinction between expenditures which are currently deductible against income and those which must be capitalized. Thus, while Section 162 of the 1954 Code and its predecessor provisions have allowed a current deduction for "ordinary and necessary [business] expenses", Section 263 forbids a current deduction for "capital expenditures." Such expenditures have been defined since the inception of the present income tax in 1913 as "any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate."[5] If an expenditure falls within the scope of this statutory definition, it constitutes the cost basis (or a part thereof) of the property (see Section 1012) and, unless the property is subject to depreciation or amortization, its cost is recoverable only when the property is ultimately sold.[6]

Capital expenditures are usually defined as those outlays made to acquire a tangible or intangible asset or benefit with a useful life of more than a year. See

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[5] This language was first used in Section II(B) of the Revenue Act of 1913, c. 16, 38 Stat. 114, 167, and has been included in each successive income tax statute.

[6] This Court has on numerous occasions considered the variant treatment accorded those business expenditures which qualify for an immediate deduction under Section 162 and those which must be capitalized under Section 263. See, *e.g.*, *Commissioner* v. *Tellier*, 383 U.S. 687, 689-690; *Spreckels* v. *Commissioner*, 315 U.S. 626; *Deputy* v. *du Pont*, 308 U.S. 488, 496-497; *Helvering* v. *Winmill*, 305 U.S. 79; *Welch* v. *Helvering*, 290 U.S. 111, 113-116.

Wells-Lee v. *Commissioner*, 360 F. 2d 665 (C.A. 8); *Teitelbaum* v. *Commissioner*, 294 F. 2d 541, 544 (C.A. 7), certiorari denied, 368 U.S. 987; *United States* v. *Akin*, 248 F. 2d 742, 744 (C.A. 10), certiorari denied, 355 U.S. 956. Since the benefit derived from costs incurred in connection with the acquisition of a capital asset, such as legal, accounting, brokerage and other similar expenses, constitute part of the cost of acquiring the asset, such outlays constitute capital expenditures to be added to the cost basis of the asset for purposes of computing gain or loss on disposition. See, *e.g.*, *Helvering* v. *Winmill*, 305 U.S. 79; *Godfrey* v. *Commissioner*, 335 F. 2d 82 (C.A. 6), certiorari denied, 379 U.S. 966; *Spangler* v. *Commissioner*, 323 F. 2d 913 (C.A. 9); *United States* v. *St. Joe Paper Co.*, 284 F. 2d 430 (C.A. 5);[7] *Atzingen-Whitehouse Dairy, Inc.* v. *Commissioner*, 36 T.C. 173. Costs incurred in connection with a corporate reorganization also are subject to capital treatment. As in the case of costs incurred in the acquisition of capital assets, reorganization expenses are capitalized because they provide a benefit extending beyond the year in which they are incurred. See, *e.g.*, *General Bancshares Corp.* v. *Commissioner*, 326 F. 2d 712, 715 (C.A. 8), certiorari denied, 379 U.S. 832; *Missouri-Kansas Pipe Line Co.* v. *Commissioner*,

[7] While the thrust of the prior decision of the Fifth Circuit in *Naylor* v. *Commissioner*, 203 F. 2d 346, is to the contrary, we believe that the subsequent opinion in *St. Joe Paper Co.* represents the law of that Circuit. Moreover, the soundness of *Naylor* has been questioned by the Ninth Circuit in *Spangler* and in 4A Mertens, Law of Federal Income Taxation (Rev.), Sec. 25A.12, n. 40.

148 F. 2d 460, 462 (C.A. 3); *Skenandoa Rayon Corp.* v. *Commissioner*, 122 F. 2d 268, 271 (C.A. 2), certiorari denied, 314 U.S. 696; *Motion Picture Capital Corp.* v. *Commissioner*, 80 F. 2d 872 (C.A. 2); *Odorono Co.* v. *Commissioner*, 26 B.T.A. 1355.[8]

The court of appeals held that these fundamental rules of federal income taxation were inapplicable to the expenses arising out of the appraisal proceeding whereby the price of the dissenting Waldorf shareholders' stock was determined. It did so on the ground that the "primary purpose" (Appendix A, *infra*, p. 23) of the appraisal proceeding was merely to determine the fair value of the dissenters' shares and was not related to their acquisition or to the merger of Waldorf into respondent. As a consequence of this analysis, the court concluded that the appraisal expenses were ordinary and necessary business expenses. Because of its failure to recognize that the rules regarding acquisitions of capital assets and corporate reorganizations were applicable to the expenses incident to the appraisal proceeding, the decision of the Seventh Circuit is unsound and should not be permitted to stand.

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[8] The rule of these cases has been expressly approved by Congress at the time of the 1954 codification. In enacting Section 248 of the 1954 Code, which allows amortization of certain organizational expenses of a corporation, both the House and Senate Committee Reports stated that "[e]xpenditures connected with the reorganization of a corporation are not incident to the creation of a corporation, and hence are not subject to the provisions of section 248." H. Rep. No. 1337, 83d Cong., 2d Sess., p. A64 (3 U.S.C. Cong. & Adm. News (1954) p. 4017, 4201); S. Rep. No. 1622, 83d Cong., 2d Sess., p. 224 (3 U.S.C. Cong. & Adm. News (1954), pp. 4621, 4860-4861).

2. The decision below is squarely in conflict with *Woodward* v. *Commissioner*, 410 F. 2d 313 (C.A. 8th), affirming, 49 T.C. 377, petition for certiorari pending, No. 412, this Term. The taxpayers in *Woodward* were majority stockholders in a corporation whose charter was due to expire in 1961. In 1960, these stockholders voted to renew the corporate existence perpetually with one minority shareholder dissenting. Since taxpayers were obligated to purchase the minority shares voting against renewal at "real value" and no agreement as to real value could be obtained, they commenced a court action in equity, identical in purpose to the appraisal proceeding in this case, to fix the value of the stock. In connection with this litigation, taxpayers paid attorneys', accountants' and appraisers' fees. Contrary to the result and reasoning of the decision below, both the Tax Court and the Eighth Circuit held that these litigation costs were nondeductible capital expenditures incident to the purchase of the dissenter's stock.

The Eighth Circuit's decision rests upon the familiar principle, to which we have referred, p. 7, *supra*, that costs incurred in connection with the acquisition of a capital asset are capital expenditures. So well established is this principle that more than thirty years ago, this Court recognized it in approving longstanding Treasury Regulations[9] to the effect

[9] Treasury Regulations 33 (1918 ed.), Article 8, par. 108; Treasury Regulations 45 (1920 ed.), Article 293; Treasury Regulations 62, Article 293; Treasury Regulations 65, Article 292; Treasury Regulations 69, Article 292, Treasury Regulations 74, Article 282; Treasury Regulations 77, Article 282; Treasury Regulations 86, Article 24-2; Treasury Regulations

that brokerage commissions paid in the purchase of securities are not deductible but must be added to the basis of the securities. *Helvering* v. *Winmill*, *supra*. The expenditures at issue here are in all pertinent respects similar to such costs as brokerage commissions paid in the purchase of securities and therefore should be treated as capital expenditures. *Erdman* v. *Commissioner*, 315 F. 2d 762 (C.A. 7); *Brown* v. *Commissioner*, 215 F. 2d 697 (C.A. 5); *Commissioner* v. *Macy*, 215 F. 2d 875 (C.A. 2); *Garrett* v. *Crenshaw*, 196 F. 2d 185 (C.A. 4); *Davis* v. *Commissioner*, 151 F. 2d 441 (C.A. 8), certiorari denied, 327 U.S. 783; *Bowers* v. *Lumpkin*, 140 F. 2d 927 (C.A. 4), certiorari denied, 322 U.S. 755; *Pennroad Corp.* v. *Commissioner*, 21 T.C. 1087, affirmed, 228 F. 2d 329 (C.A. 3).

Woodward cannot be distinguished on the ground that the appraisal proceeding there occurred before title to the dissenter's stock passed to the taxpayers, while in this case the title transfer and merger were effected in advance of the appraisal proceeding in accordance with the pertinent provisions of New York law.[10] The basis for the *Woodward* holding re-

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94, Article 24-2; Treasury Regulations 101, Article 24-2; Treasury Regulations 103, Section 19.24-2; Treasury Regulations 111, Section 29.24-2; Treasury Regulations 118, Section 39-24(a)-2; Treasury Regulations (1954 Code), Section 1.263(a)-2(e), Appendix C, *infra*, p. 26.

[10] To the extent the Eighth Circuit (410 F. 2d at 320) attempted to distinguish this case, involving a claimed deduction for ordinary and necessary business expenses under Section 162, from *Woodward*, involving a deduction for expenses for the production or collection of income under Sec-

quiring capitalization was not that title was involved, but rather that the appraisal costs were directly related to the acquisition of the dissenter's stock. In this case, no less than in *Woodward*, the appraisal proceeding was "inextricably woven into the fabric of the overall transaction." 410 F. 2d at 320.[11]

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tion 212, we believe the distinction to be without merit. The deduction under Section 212 and its predecessor provision (Section 23(a)(2) of the 1939 Code, as amended by Section 121(a) of the Revenue Act of 1942, c. 619, 56 Stat. 798, 819) is subject to the same restrictions imposed upon business expense deductions, except it removed the requirement that the expense be incurred in connection with a trade or business. *Trust of Bingham* v. *Commissioner*, 325 U.S. 365; *Lykes* v. *United States*, 343 U.S. 118; Treasury Regulations (1954 Code), Section 1.212-1(n); H. Rep. No. 2333, 77th Cong., 2d Sess., p. 75 (1942-2 Cum. Bull. 372, 430); S. Rep. No. 1631, 77th Cong., 2d Sess., p. 88 (1942-2 Cum. Bull. 504, 571). See also *United States* v. *Gilmore*, 372 U.S. 39, 44-47. The provisions of Section 212 do not in any way impair the established rule that expenses incidental to the purchase of a capital asset are capital expenditures, to be reflected in the computation of the capital gain or loss recognized when the asset is sold. To the contrary, as the Ninth Circuit observed in *Spangler* v. *Commissioner*, *supra*, 323 F. 2d at 918 —"Section 23(a)(2), adopted in 1942 [now Section 212 of the 1954 Code] did not create new types of deductible expenditures; it simply made the old deductions applicable to new categories of income-producing activity." Since the foregoing considerations were set forth by the Eighth Circuit earlier in its *Woodward* opinion 410 F. 2d at 317-318) it diminishes the force of its subsequent distinction (410 F. 2d at 320) between Sections 162 and 212.

[11] That the decision below runs contrary to the mainstream of case law in this area was recognized by the Eighth Circuit in *Woodward*. In discussing the relevant authorities, the Eighth Circuit implicitly disapproved (410 F. 2d at 320) the holding in *Smith Hotel Enterprises* v. *Nelson*, 236 F. Supp. 303 (E.D. Wis.), principally relied upon by the decision below,

3. Relying on New York law, the court of appeals determined that the appraisal proceeding did not function primarily to permit the acquisition of the dissenting Waldorf shareholders' stock and was not necessary to the consummation of the merger. Appendix A, *infra*, pp. 21-23. The court therefore concluded that the primary purpose of the appraisal proceeding was simply to value the dissenters' shares, and that the expenses incurred in connection therewith were ordinary and necessary business expenses.

In finding the appraisal proceeding to be a distinct event conceptually separate from the acquisition of the dissenters' shares or the merger, the court of appeals fell into error. That proceeding was not only

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and endorsed as the "better view" the decision of *Boulder Building Corp.* v. *United States*, 125 F. Supp. 512 (W.D. Okla.). Moreover, an examination of the district court's opinion in *Smith Hotel Enterprises* reveals that its principal reliance was upon *Heller* v. *Commissioner*, 147 F. 2d 376 (C.A. 9), certiorari denied, 325 U.S. 868. There, the Ninth Circuit held that the appraisal proceeding expenses incurred by a dissenting shareholder were deductible under Section 212. But the subsequent decision of that court in *Spangler* v. *Commissioner*, 323 F. 2d 913, expressly disapproved its prior *Heller* decision to the extent that it may have been premised on the assumption that the predecessor of Section 212 "created a new category of deductions". See 323 F. 2d, pp. 919-920, n. 15. We therefore believe that the *Spangler* decision represents the governing rule in the Ninth Circuit. In that case, the taxpayer sought to deduct litigation expenses of a suit in which she recovered, *inter alia*, the value of stock on liquidation. The Ninth Circuit held that the litigation expenditure was a capital outlay on the theory that "Costs connected with the disposition of a capital asset are also capital expenditures to be added to taxpayer's basis, or offset against the sales price, rather than expenses deductible from ordinary income." See 323 F. 2d at 921.

directly related to the acquisition or merger, but indeed, had no independent purpose of its own. The fact that the stock acquisition or merger preceded the appraisal proceeding under state law cannot mask their functional relationship for federal tax purposes. See *Spangler* v. *Commissioner*, 323 F. 2d 913, 921 (C.A. 9); *Munson* v. *McGinnes*, 283 F. 2d 333 (C.A. 3), certiorari denied, 364 U.S. 880. See also *Arrowsmith* v. *Commissioner*, 344 U.S. 6.

4. The court below and the Eighth Circuit in *Woodward* disagreed not only as to the ultimate treatment of the appraisal expenses incurred in each case but also as to the proper test to be applied in characterizing the expenses for tax purposes. While the court below held that the "primary purpose" test of its decision in *Rassenfoss* v. *Commissioner*, 158 F. 2d 764 (C.A. 7), was applicable, the Eighth Circuit specifically considered and rejected this test as having no application to litigation expenses that are directly connected to the acquisition of a capital asset. 410 F. 2d at 316. As the Eighth Circuit explained, the "primary purpose" test is relevant only in the case of litigation concerning title to property, where the general rule has been that the cost of defending or perfecting title to property is a nondeductible capital expenditure. Treasury Regulations on Income Tax (1954 Code), Section 1.263(a)-(2)(c), Appendix C, *infra*, p. 26. As an adjunct to this rule, some courts have employed a "primary purpose" test and have allowed a current deduction where title was involved but the defense or perfection of that title was only incidental to the litigation. See, *e.g.*, *Rassenfoss* v.

Commissioner, supra; Manufacturers Hanover Trust Co. v. *United States*, 312 F. 2d 785 (Ct. Cl.), and cases cited therein. See also *Kornhauser* v. *United States*, 276 U.S. 145.

United States v. *Gilmore*, 372 U.S. 39, not cited by the court below, but relied upon by the Eighth Circuit in *Woodward*, 410 F. 2d at 319, prescribes the test to be applied in determining the treatment of the appraisal expenses incurred by Hilton. In *Gilmore*, this Court held that this determination is to be made by reference to "the origin and character of the claim with respect to which an expense was incurred." 372 U.S. at 49. Although *Gilmore* involved the question whether certain expenses were business or personal expenses, its rationale applies with equal force in this case. Since the origin of the claim with respect to which the appraisal expenses were incurred was the stock acquisition or merger, and since the character of the claim indisputably was capital in nature—the amount to be paid for a capital asset or in connection with a corporate reorganization—the appraisal expenses must be considered a part of the cost of acquiring the shares and thus a nondeductible capital expenditure.

5. The court of appeals thought that its "conclusion in this case obviously is a narrow one related specifically to a factual situation controlled by New York statutes." Appendix A, *infra*, p. 23. Quite the contrary is true, however. Our research has disclosed that in addition to New York, 48 other states and the District of Columbia [12] accord dissenting share-

[12] The lone exception is West Virgina.

holders an appraisal remedy,[13] and that in all of these jurisdictions the general rule is that a duly approved

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[13] Code of Ala., tit. 10, §§ 21(66), 21(73); Alaska Comp. Stat. Ann., §§ 36-2A-93, 36-2A-95, 36-2A-97; Ariz. Rev. Stat. Ann., §§ 10-345, 10-346, 10-347; Ark. Stat. Ann. §§ 64-703—64-705, 64-707; Calif. Corp. Code, §§ 4113, 4123, 4300; Colo. Rev. Stat. Ann., §§ 31-7-3, 31-7-4, 31-7-5, 31-7-8; Conn. Gen. Stat. Ann., §§ 33-366, 33-367, 33-368, 33-374; Del. Code. Ann., tit. 8, §§ 251, 262; D.C. Code, § 29-240; Fla. Stat. Ann., §§ 608.-20, 608.23; Code of Ga. Ann., §§ 22-1838, 22-1845—22-1847; Hawaii Rev. Stat., §§ 417-3, 417-4, 417-8, 417-19—417-26; Idaho Code, §§ 30-152, 30-154, 30-156; Smith-Hurd III. Ann. Stat., ch. 32, §§ 157.63—157.70; Burns Ind. Ann. Stat. §§ 25-231—25-236; Iowa Code Ann., §§ 491.104—491.108, 491.112; Kan. Stat. Ann., §§ 17-3701—17-3707; Ky. Rev. Stat., §§ 271.470, 271.480, 271.490; La. Rev. Stat. Anno., Rev. Stat. §§ 12.112, 12.114, 12.131; Me. Rev. Stat. Ann., tit. 13, §§ 242-244, 281-291; Ann. Code of Md., Art. 23, §§ 66, 73; Mass. Ann. Laws, ch. 156, §§ 46A, 46B, 46E; Mich. Stat. Ann., §§ 21.52-21.54; Minn. Stat. Ann., §§ 301.42, 301.44; Miss. Code Ann., §§ 5309-151, 5309-153, 5309-156, 5309-172; Vernon's Ann. Mo. Stat., §§ 351.420, 351.425, 351.440, 351.455; Rev. Codes of Mont. Ann., §§ 15-2267, 15-2269, 15-2273, 15-2274; Rev. Stat. of Neb., §§ 21-1,104, 21-1,109; Nev. Rev. Stat., §§ 78.450, 78.505; N.H. Rev. Stat. Ann., §§ 294:42, 294:77—294:80; N. J. Stat. Ann., §§ 14A:10-3, 14A:10-4, 14A:11-1—14A:11-9; N.M. Stat. Ann., §§ 51-27-1—51-27-3, 51-27-6, 51-28-3—51-28-4; Gen. Stat. of N.C., §§ 55-108—55-110, 55-113; N.D Cent. Code Ann., §§10-20-03, 10-20-04, 10-20-06, 10-20-08; Page's Ohio Rev. Code Ann., §§ 1701.79, 1701.80, 1701.85; Okla. Stat. Ann., tit. 18, §§ 1.157—1.161, 1.166; Ore. Rev. Stat., §§ 57.432—57.475; Purdon's Pa. Stat. Ann., tit. 15, §§ 801—805, 1515. 1905—1908; Gen. Laws of R.I., §§ 7-5-3, 7-5-7, 7-5-8—7-5-15; Laws of S.C., §§ 12-16.27, 12-20.1—12-20.9; S.D. Code, §§ 11.02A01—11.02A07; Tenn. Code Ann., §§ 48-901—48-905, 48-909—48-918; Business Corp. Act, Vernon's Tex. Civ. Stat., Arts. 5.07, 5.11, 5.12; Utah Code Ann., §§ 16-10-68, 16-10-69, 16-10-75, 16-10-76; Vt. Stat. Ann., tit. 11, §§ 38-161, 38-162, 38-381, 38-382; Va. Code Ann., §§ 13.1-70—13.1-75; Rev. Code of Wash. Ann., §§ 23A.20.010—23A.20.060, 23A.24.030—23A.24.040; West's Wis. Stat. Ann., §§ 180.64—180.69; Wyo. Stat. Ann., §§ 17-36.63—17-36.72.

merger or consolidation becomes effective upon the filing or recordation of an appropriate certificate with state authorities even though some shareholders may have dissented. The federal law relating to the merger or consolidation of national banking institutions, which also provides an appraisal remedy, likewise permits a merger to be effected before dissenting shareholders have been compensated for their stock. 12 U.S.C. 214a(b).

Given the widespread availability of appraisal remedies under both state and federal law and the relatively large numbers of corporate mergers and acquisitions in recent years, the question in this case is one which will constantly recur.[14] Furthermore, it is a question that particularly affects the planning of corporate acquisitions where the attendant expenses incident to an appraisal proceeding can be quite substantial. It is essential, therefore, that both the tax bar and the Treasury have a settled rule as to whether such expenditures are capital in nature or whether

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[14] We have been advised by the Internal Revenue Service that apart from *Woodward* and the instant case, there is one other case pending in the courts involving the deductibility of fees incurred in connection with appraisal proceedings. The total amount of revenue involved in these three cases is approximately $53,000. In addition, there are 60 cases pending administratively involving $2,598,977 of revenue, which includes $56,510 arising out of a similar merger transaction involving respondent for subsequent years. This figure also includes $32,500 of revenue in a case involving the petitioners in *Woodward* for subsequent years. Moreover, there are at least 11 cases pending in the courts concerning the deductibility of fees paid in connection with the acquisition or sale of stock, which involve approximately $250,000 of deductions. With respect to this issue, there are 75 cases pending administratively involving $5,887,854 of revenue.

they may be deducted currently. This objective can be achieved only through a resolution by this Court of the conflict of decisions between the Seventh and Eighth Circuits.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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JOHNNIE M. WALTERS,
Assistant Attorney General.

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Attorneys.

AUGUST 1969.

APPENDIX A

IN THE UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT

SEPTEMBER TERM, 1968—JANUARY SESSION, 1969

No. 17124

HILTON HOTELS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

April 15, 1969

Before HASTINGS, Senior Circuit Judge, and KILEY and KERNER, *Circuit Judges.*

HASTINGS, *Senior Circuit Judge.* The United States appeals from a district court decision in a refund suit brought by taxpayer Hilton Hotels Corporation (Hilton). The sole issue raised by this appeal [1] is whether the district court erred, as the Government contends, in holding that expenditures incurred by Hilton in connection with an appraisal proceeding to value the stock of dissenting shareholders in a merged corporation are currently deductible ordinary and necessary business expenses. The Gov-

[1] One of the two issues originally presented in this case was settled by the parties.

ernment urges that such expenditures are nondeductible capital outlays.

The relevant facts were stipulated by the parties and adopted by the lower court. They may be summarized in the following manner.

On September 2, 1953, Hilton owned 325,370.5 of the 366,040.75 issued shares of the Hotel Waldorf-Astoria Corporation (Waldorf); the remaining 40,670.25 shares of Waldorf were owned by shareholders other than Hilton or Waldorf.

Contemplating a merger, Hilton retained Standard Research Consultants, Inc. (Standard) to prepare a merger study to determine a fair basis of exchange of Hilton stock for the remaining 40,670.25 shares of Waldorf. Standard concluded that a fair exchange ratio would be 1.25 shares of Hilton common stock for each remaining share of Waldorf stock.

On November 12, 1953, Hilton and Waldorf entered into an agreement of merger which provided that Hilton would be the surviving corporation and that 1.25 of Hilton's shares would be offered for each of the remaining 40,670.25 shares of Waldorf.

The holders of over two-thirds of the stock of Hilton and Waldorf voted in favor of the merger on December 28 and 29, 1953. Prior to this vote of approval, however, the holders of 20,221 shares of Waldorf filed with Waldorf, pursuant to § 91 of the New York Stock Corporation Law,[2] their written objec-

[2] Section 91 reads in relevant part:

"7. Any stockholder * * * included in such consolidation, not voting in favor thereof, may object * * * and demand payment for his stock, at any time prior to the vote * * * The objecting stockholder or the corporation shall have the right to have such stock appraised and paid for in the manner provided, and subject to the conditions imposed by section twenty-one. * * *."

tions to the proposed merger and demanded payment for their stock.

On December 31, 1953, the merger agreement and the certificate of consolidation were filed and recorded with the Secretary of State of New York in accordance with the relevant provisions of § 91. Thereafter and pursuant to § 21, Subdivision 1, of the New York Stock Corporation Law [3], Hilton offered to the objecting holders of the Waldorf stock a payment of $24.54 for each share of the remaining 20,221 shares. The Hilton offer was rejected, and on February 11, 1954, pursuant to § 21 [4], the dissenting holders commenced appraisal proceedings in the Supreme Court for the County of New York to determine the value of their shares of Waldorf. These proceedings continued until June 14, 1955, when the New York court approved the parties' settlement of

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[3] Section 21 reads in relevant part:

"1. In the event that the stockholders of a corporation have taken action pursuant to [section] * * * ninety-one * * * and if any stockholder has objected to such action and demanded payment for his stock as provided in * * * section ninety-one * * * the corporation, * * *, shall mail * * * to such objecting stockholder * * * a written offer to pay for such stock in cash at a price deemed by the corporation to be the value thereof; * * *."

[4] Section 21 reads in relevant part:

"3. If the corporation shall fail to make an offer within the time specified in subdivision one hereof, or if the objecting stockholder shall fail to accept an offer from the corporation within twenty days after the mailing * * *, either such stockholder or the corporation may petition the supreme court, at any special term thereof held within the judicial district in which the principal office of the corporation is situated, to determine the value of such stock."

the valuation dispute and ordered the appraisal proceedings terminated.

This suit presents the problem of characterizing for the purpose of taxation the nature of the expenses incurred by Hilton in connection with the appraisal proceeding.

It is axiomatic that if the Hilton expenditures are deemed to have been incurred, as the Government urges, in corporate reorganization or recapitalization they are not deductible. *General Bancshares Corp.* v. *C.I.R.*, 8 Cir., 326 F. 2d 712, 715, *cert. denied*, 379 U.S. 832 (1964) and cases cited therein. It is equally true, however, that if such expenditures are held to be ordinary and necessary business expenses they are deductible. Int. Rev. Code of 1954, § 162.

The line of demarcation between the deductible and the nondeductible expenditure is frequently difficult to perceive because the "* * * decisive distinctions [between the two] are those of degree and not of kind." *Welch* v. *Helvering*, 290 U.S. 111, 114 (1933). The applicable rule generally held to govern in such situations is the *primary purpose* test. *Rassenfoss* v. *Commissioner of Internal Revenue*, 7 Cir., 158 F. 2d 764, 767 (1946); *Manufacturers Hanover Trust Co.* v. *United States*, U. S. Ct. Cl., 312 F. 2d 785, 789, *cert. denied*, 375 U.S. 880 (1963).

In the instant case, we are satisfied the district court appropriately considered and applied the primary purpose doctrine and affirm its decision which held that the Hilton expenditures, arising out of the appraisal proceedings, were deductible as ordinary and necessary business expenses. *Hilton Hotels* v. *United States*, D.C. N.D. Ill., 285 F. Supp. 617 (1968).

In reaching its decision, the district court found that the Hilton-Waldorf merger became effective un-

der New York law upon filing the Certificate of Consolidation with the Secretary of State.[5] It further found under New York law that the objecting Waldorf holders had no interest other than to receive payment of the fair value of their stock[6] and that the *sole purpose* of the appraisal proceedings was to determine the fair value of the objecting holders' shares in Waldorf. As a result of such findings, the court concluded that the expenses experienced by Hilton in connection with such proceedings were not capital in nature and were therefore deductible as ordinary and necessary business expenses. We agree.

Like the district court, we feel that the rationale of *Smith Hotel Enterprises, Inc.* v. *Nelson*, D.C.E.D. Wisc., 236 F. Supp. 303 (1964) is germane to the instant case. In *Smith*, the corporate taxpayer received an offer to purchase substantially all its assets. One shareholder objected to the offer and pursuant to the controlling state statute demanded from the

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[5] Section 91 of the New York Stock Corporation Law reads in material part:

> "9. The consolidation authorized by the provisions of this section shall become effective for all purposes of the laws of this state upon filing in the office of the secretary of state the certificate [of consolidation] * * *."

[6] Section 21 of the New York Stock Corporation Law provides:

> "6. Any stockholder demanding payment for his stock shall have no right to receive any dividends or distribution payable to holders of such stock of record after the close of business on the day next preceding the date of the stockholders' vote in favor of the action to which such objection was made, and upon such vote shall cease to have any other rights of a stockholder of the corporation in respect to such stock, *except the right to receive payment for the value thereof* * * *." [Emphasis supplied.]

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APPENDIX B

JUDGMENT

UNITED STATES COURT OF APPEALS
FOR THE SEVENTH CIRCUIT
Chicago, Illinois 60604

No. 17124

Tuesday, April 15, 1969

HILTON HOTELS CORPORATION, PLAINTIFF-APPELLEE

v.

UNITED STATES OF AMERICA, DEFENDANT-APPELLANT

Appeal from the United States District Court for the Northern District of Illinois, Eastern Division

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Before HON. JOHN S. HASTINGS, *Senior Circuit Judge*, HON. ROGER J. KILEY, *Circuit Judge*, HON. OTTO KERNER, *Circuit Judge*.

This cause came on to be heard on the transcript of the record from the United States District Court for the Northern District of Illinois, Eastern Division, and was argued by counsel.

On consideration whereof, it is ordered and adjudged by this court that the judgment of the said District Court in this cause appealed from be, and the same is hereby, AFFIRMED, with costs, in accordance with the opinion of this Court filed this day.

APPENDIX C

Internal Revenue Code of 1954:

SEC. 162. TRADE OR BUSINESS EXPENSES.

(a) *In General.*—There shall be allowed as a deduction all the ordinary and necessary expenses paid or incurred during the taxable year in carrying on any trade or business, including—

(1) a reasonable allowance for salaries or other compensation for personal services actually rendered;

(2) traveling expenses (including amounts expended for meals and lodging other than amounts which are lavish or extravagant under the circumstances) while away from home in the pursuit of a trade or business; and

(3) rentals or other payments required to be made as a condition to the continued use or possession, for purposes of the trade or business, of property to which the taxpayer has not taken or is not taking title or in which he has no equity.

For purposes of the preceding sentence, the place of residence of a Member of Congress (including any Delegate and Resident Commissioner) within the State, congressional district, Territory, or possession which he represents in Congress shall be considered his home, but amounts expended by such Members within each taxable year for living expenses shall not be deductible for income tax purposes in excess of $3,000.

* * * *

[26 U.S.C. 162.]

SEC. 263. CAPITAL EXPENDITURES.

(a) *General Rule.*—No deduction shall be allowed for—

(1) Any amount paid out for new buildings or for permanent improvements or betterments made to increase the value of any property or estate. This paragraph shall not apply to—

(A) expenditures for the development of mines or depostis deductible under section 616,

(B) research and experimental expenditures deductible under section 174, or

(C) soil and water conservation expenditures deductible under section 175.

* * * *

[26 U.S.C. 263.]

Treasury Regulations on Income Tax (1954 Code):

Sec. 1.263(a)-2 *Examples of capital expenditures.*

The following paragraphs of this section include examples of capital expenditures:

* * * *

(c) The cost of defending or perfecting title to property. * * * *

(e) Commissions paid in purchasing securities. Commissions paid in selling securities are an offset against the selling price, except that in the case of dealers in securities such commissions may be treated as an ordinary and necessary business expense.

* * * *

(26 C.F.R. 1.263(a)-2.)

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